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June 20, 2006

## **AGENDA ITEM 5**

### **TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE**

- I. SUBJECT:** Second Reading – Blue Shield of California – Three-Year HMO Contract Renewal
- II. PROGRAM:** Health Benefits
- III. RECOMMENDATION:** Staff recommends the Board approve a three-year HMO contract renewal with Blue Shield of California effective January 1, 2007.

### **IV. INTRODUCTION:**

The current 3-year contract with Blue Shield of California (Blue Shield) as the exclusive CalPERS Health Benefits Program HMO network plan expires on December 31, 2006. At the May 16, 2006, Health Benefits Committee meeting, representatives from Blue Shield presented a proposed 3-year business plan to demonstrate the value of a continued partnership and multi-year contract.

### **V. BACKGROUND:**

In June 2002, the CalPERS Board voted to eliminate two major health plans and consolidate its network HMO membership with Blue Shield of California effective January 2003. As a result of this decision, CalPERS saved an estimated \$77 million in premiums for 2003. As was CalPERS usual practice at the time, the Blue Shield contract award was for one year on a fully insured basis. Because pricing for 2004 must occur in 2003, Blue Shield had little or no claims data for nearly 350,000 new members (75% of their CalPERS membership), causing a high degree of uncertainty in its pricing estimates. In the absence of reliable claims experience, Blue Shield's initial conservative assumptions resulted in a proposed overall Blue Shield Basic Plan rate increase of nearly 37% for 2004. Because it was not in the best interest of CalPERS to eliminate another health plan and since the prospect of annually bidding and moving members between plans was great, CalPERS and Blue Shield developed a risk sharing "partnership model" that ultimately resulted in a Basic Plan premium increase of 18.44% for 2004. Simultaneously, Blue Shield was awarded a 3-year contract. The foundation for the partnership was established on three guiding principles:

- Transparency – CalPERS has access to detailed HIPAA compliant data elements that increase understanding of health care cost drivers;

- Accountability – CalPERS expects industry standard benchmarking to be used for performance measurement;
- Aligned incentives – CalPERS requires pay-for-performance terms for providers and the health plan ensures that appropriate attention is placed on unit costs, utilization, and improving health status.

The partnership additionally focused on the achievement of several goals:

- Receive the appropriate level of health plan focus to gain control of rising unit costs and utilization trends;
- Gain increased understanding of market dynamics through data transparency;
- Increase price stability for CalPERS network HMO members; and
- Hold the health plan partner accountable for performance.

The current 3-year contract required Blue Shield to offer an HMO benefit in each of the 40 counties that had an existing HMO plan at that time. To accomplish this, Blue Shield had to establish a provider network in 6 Exclusive Provider Organization (EPO) and 10 Direct Contract (DC) counties within a 6-month timeframe.

## **VI. ANALYSIS:**

The following key successes can be attributed to the CalPERS-Blue Shield partnership model:

- CalPERS buying power was leveraged with key health care providers by moderating year-over-year price increases.
- The adoption of a hospital narrow network to address hospital costs as a significant expense driver. Nearly \$31 million in savings were realized in 2005; an additional \$45 million in savings is projected to be achieved annually thereafter.
- The hospital narrow network was a catalyst for developing the “Partnership for Change” leading the drive for improved and standardized efficiency toward cost effectiveness for California hospitals.

The requirement that Blue Shield offer an HMO benefit in certain EPO and DC counties\* is having a substantially negative impact on the overall CalPERS Blue Shield premium. Under a separate agenda item, Blue Shield is proposing actions to mitigate this situation. As our future partner, we expect Blue Shield will continue to use data gathering and analytics to drive decision making and recommendations for improving the CalPERS Health Benefits Program.

To support a 3-year renewal, CalPERS negotiated and Blue Shield accepted decreases from the 2006 Blue Shield administrative fees and profits for 2007.

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\* The DC/EPO counties include: Butte, Colusa, El Dorado, Glenn, Lake, Mariposa, Mendocino, Merced, Napa, Plumas, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Sierra, and Sonoma

Additionally, CalPERS has secured a rate cap on administrative fees for 2008 and 2009.

CalPERS engaged a third party independent actuary to assess if Blue Shield has been a good financial partner over the past three years and whether it would be providing competitive rates into the future. Independent audit results indicated:

- 1) Using state and national comparisons, Blue Shield's actuarial work is rigorous and sophisticated.
- 2) Blue Shield's cost of health care calculations is consistent with the auditor's estimate of actual costs in the market.
- 3) Blue Shield provides the best of value in its core service areas (i.e. best networks, best care management, best discounts, etc.)
- 4) Administrative fees and retention are both competitive and reasonable.

Blue Shield has also agreed to put a substantial portion of its administrative fees and profits at risk to support a 3-year renewal to identify opportunities for cost savings in health care delivery through appropriate levels and locations of services. Staff and Blue Shield are working to expand existing performance goals for providing cost-effective health care delivery for another three years. Expanded performance goals will underscore various business requirements including:

- Disease Management – Blue Shield has enrolled more than 3200 members in programs for management of asthma, chronic obstructive pulmonary disease (COPD), congestive heart failure (CHF), coronary artery disease (CAD), and diabetes. Blue Shield has agreed to increase the number of members enrolled in these programs. Preliminary reports project significant annual health care cost savings for these members, especially related to reduction of inpatient admissions and lengths of stay.
- High Intensity Case Management – Blue Shield managed more than 480 inpatient cases saving more than \$6 million, primarily for neonatal and trauma cases. This program requires daily interaction with attending physicians to identify treatment options and coordinate care between multiple providers. These programs are most critical when members, due to emergency situations, receive services at substantially higher costs outside of the CalPERS network. This program will continue into the future and additional diagnoses are being piloted and cost benefit analyses conducted for inclusion in 2007.
- Utilization Management – Blue Shield is working closely with physicians to deliver health care services at appropriate levels and location of service. Due to the high volume of services, increased use of MRIs and CT scans, and variability in pricing between providers, radiology and laboratory services have been targeted for increased oversight in 2006 and 2007.
- Provider Engagement – Blue Shield will continue its program to evaluate physicians practice patterns and identify opportunities for greater efficiency

and cost effectiveness in the areas of specialty referrals, diagnostics, and inpatient care. These activities are especially important in rural communities.

- Member Engagement – Effective January 1, 2007, Blue Shield will, for the next three years, fund the Health Lifestyle Rewards program offered to all Blue Shield HMO CalPERS adult members (18 years and older), including supplement to MediCare members. This program is expected to cost approximately \$5 million annually. Members will have the opportunity to earn \$200 in cash awards each year for engaging in behavioral change that should have an impact on their health status. CalPERS will benefit from non-member specific reporting that summarizes results of health risk assessments, member participation in programs such as weight loss, stress management, and smoking cessation.
- Regional Councils – Blue Shield is committed to working with CalPERS staff, employers, labor, providers, and members to share data related to high cost services in direct contract counties. As the data becomes more transparent, community leaders will be asked to work with providers to identify opportunities for cost savings. Blue Shield will prepare data/information for presentation at the meetings, invite and coordinate participants, develop actions plans, and ensure appropriate follow-up activities.

In addition, Blue Shield has agreed to:

- Work with CalPERS to increase transparency in health care cost drivers;
- Involve CalPERS, when appropriate, in provider contract management; and,
- Support sales efforts to grow membership through public agency recruitment and retention.

#### **VII. STAFF RECOMMENDATION:**

Staff recommends the Board approve a three-year HMO contract renewal with Blue Shield of California effective January 1, 2007.

#### **VIII. STRATEGIC PLAN:**

This item supports Goal X of the CalPERS strategic plan, “Develop and administer quality, sustainable health benefit programs that are responsive to and valued by enrollees and employers.” It also supports Goal XI, “Promote the ability of members and employers to make informed decisions resulting in improved lifestyle choices and health outcomes.”

**VIII. RESULTS/COSTS**

The CalPERS costs associated with this item are included in the annual budget of the Office of Health Plan Administration.

Staff is available to respond to any questions.

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